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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D., 1947

No. 328

ADAMSTON FLAT GLASS COMPANY,
A CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT OF PETITION.

CHARLES W. MOXLEY,
Counsel for Petitioner.

William M. Drennen
JACKSON, KELLY, MORRISON & MOXLEY,
1601 Kanawha Valley Building
Charleston, West Virginia
Of Counsel

September, 1947.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, Adamston Flat Glass Company, a corporation, petitioner in the United States Circuit Court of Appeals for the Fourth Circuit, respectfully prays that a writ of certiorari issue to review a judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in this case on June 5,

1947, affirming an order of The Tax Court of the United States entered August 5, 1946.

It has been stipulated by the parties that, for the purpose of this petition for writ of certiorari, the printed record may consist of the following:

1. Appendix to petitioner's brief in the United States Circuit Court of Appeals for the Fourth Circuit.

2. The proceedings had before the United States Circuit Court of Appeals for the Fourth Circuit.

For convenient reference, an appendix is annexed to the brief in support of this petition which includes the statutes here involved, the opinion of the Circuit Court in this case, and the opinion of the Circuit Court of Appeals for the Sixth Circuit in *Muskegon Motor Specialties Company v. Commissioner of Internal Revenue*, 134 F (2d) 904 (Cert. denied 320 U. S. 741, 88 L. Ed. 440). Reference to this appendix will be (App. ....).

OPINIONS BELOW

The opinion of The Tax Court of the United States is a part of the record (R. 130) and is reported in 7 T. C. No. 61. The opinion of the Circuit Court of Appeals is a part of the record (R. 152) and is also reproduced in the Appendix to the brief filed in support of this petition (App. 31), but has not yet been officially reported.

JURISDICTION

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the act of February 13, 1925, (28 U. S. C. A. §347).

The judgment of the Circuit Court of Appeals was entered on June 5, 1947.

STATUTES INVOLVED

The issues raised in this petition involve the construction and application to the facts in this case of Section 113(a)(7)(A), Internal Revenue Code (26 U. S. C. A. §113).

The basic issue in the case, the basis for depreciation of certain of petitioner's assets, must be determined by reference to Section 114(a), Internal Revenue Code (26 U. S. C. A. §114), which refers to Section 113(b), Internal Revenue Code (26 U. S. C. A. §113), but the issues raised in this petition must be determined under Section 113(a)(7)(A). Section 203 (h)(1)(A), Revenue Act of 1926 (26 U. S. C. A., Internal Revenue Acts, 1940 Edition p. 150, Revenue Act of 1926, c. 27; 44 Stat. 12) was involved in the proceedings below.

SUMMARY STATEMENT OF THE MATTER INVOLVED

The material facts are presented in some detail in the opinion of the Circuit Court, reproduced in the appendix hereto, and in the findings of fact made

by the Tax Court (R. 131). Condensed for the purposes of this petition, the nature of the proceeding and the facts of the case are as follows:

Nature of the Proceeding

The Commissioner of Internal Revenue determined deficiencies in income taxes against petitioner for the calendar years 1940, 1941, 1942 in the aggregate sum of $2,522.80, while petitioner claims overassessments for those years in the aggregate amount of $34,643.58. The asserted deficiencies were founded upon use by the Commissioner of cost to petitioner as the basis for depreciation of certain assets formerly belonging to Clarksburg Glass Company (hereinafter referred to as Clarksburg) acquired by petitioner in 1926. Petitioner claims said assets were acquired in connection with a statutory reorganization, as defined by the Revenue Act of 1926, and that it is entitled to use as the basis for depreciation of those assets the same basis applied to the properties in the hands of the former owner.

Section 114(a), Internal Revenue Code, states that the basis for depreciation of property shall be the adjusted basis provided in Section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property. Section 113(b), Internal Revenue Code, states that the adjusted basis for determining the gain or loss from the sale or other disposition of property shall be the basis determined under subsection (a), adjusted as provided in subsection (b). Section 113(a), In-

ternal Revenue Code, provides that the unadjusted basis of property shall be the cost of such property; except that

> "* * *
>
> "(7) Transfers to corporation.—If the property was acquired—
>
> "(A) After December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or
>
> * * *
>
> then the basis shall be the same as it would be in the hands of the transferor * * *."

Petitioner instituted these proceedings in the Tax Court of the United States for a redetermination of the deficiencies. The Tax Court, in its opinion (R. 147), assumed, without deciding, that the 50 per cent. interest in the property remained, after the transfer, in creditors of the old corporation, "or any of them", within the statutory language, but held that there was no reorganization and entered decision finding deficiencies in petitioner's tax for the years involved in the amounts assessed by respondent (R. 150).

Upon petition for review filed by petitioner in the Circuit Court of Appeals for the Fourth Circuit, that Court, in its opinion (App. 39), found that there

was a reorganization and that petitioner acquired the properties in connection with that reorganization but nevertheless affirmed the decision of the Tax Court because it found the transfer to the taxpayer in connection with the reorganization did not meet the requirement of Section 113(a)(7)(A) of the Internal Revenue Code that "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them" (App. 40). The basis for this latter conclusion was that the statutory language above quoted requires that those persons who acquire a 50 per cent. interest or control in the properties after the transfer must have had at least a 50 per cent. interest or control before the transfer (App. 46).

If it shall be held that petitioner is entitled to use as the basis for depreciation of the assets here involved the basis applied to the assets in the hands of Clarksburg Glass Company, it has been stipulated that the depreciation deductions for the years involved shall be computed in accordance with Rule 50 of The Tax Court's Rules of Practice and are to be based upon the figures contained in Exhibit 26 attached to the Stipulation of Facts (R. 26).

Facts

A summary statement of the facts pertinent to the questions presented in this petition follows.

Prior to January 1, 1926, Clarksburg Glass Company, the former owner of the properties the basis

for depreciation of which is here involved, experienced financial difficulties. Its properties were encumbered with a first mortgage securing notes in the aggregate amount of $150,000 payable one each year over a period of years, and with a second mortgage securing notes payable to Pittsburgh Plate Glass Company in the aggregate amount of $100,000, the entire amount of which, due to an acceleration clause, became payable January 1, 1926, upon default in payment of the note due on that date.

Pittsburgh Plate Glass Company instituted proceedings to foreclose its mortgage in January, 1946, seeking a sale of the properties subject to the first mortgage. Stockholders of Clarksburg and its principal unsecured creditor, Clarksburg Flat Glass Company, a company which had been formed in 1925 to consolidate Clarksburg and American Sheet Glass Company and whose sole assets were unsecured notes of Clarksburg evidencing advances made by Clarksburg Flat Glass Company from the proceeds of the sale of its capital stock to meet operating expenses of Clarksburg, immediately began negotiations with Pittsburgh to work out a plan whereby those interested in the two companies might forestall foreclosure and retain the properties. The outcome of these negotiations was a plan whereby Pittsburgh would buy in the properties at the foreclosure sale and would then transfer the properties to a new corporation to be formed by the stockholders and creditors of Clarksburg who were interested in retaining the properties, the new company to assume the first mortgage and pay Pittsburgh just enough

to cover its out of pocket expenses in connection with the foreclosure and reduce the amount of its indebtedness by one-third, the remaining two-thirds to be covered by notes of the new company—in other words to make Pittsburgh come out whole on the transaction and no more. Petitioner was incorporated in June, 1926, as the new company to which the properties would be transferred. The plan was consummated and petitioner acquired the properties here involved in connection with that plan of reorganization.

Prior to the reorganization Clarksburg had outstanding 18,215 shares of voting stock and 3,061 non-voting shares, of which twelve shareholders owned 8,605 voting and 739 non-voting shares. These twelve stockholders acquired 754 of the 1500 shares of stock issued by petitioner. Thus stockholders who owned 44 per cent. of all the shares and a little more than 47 per cent. of the voting shares of Clarksburg before the transfer owned a little over 50 per cent. of the stock of Adamston after the transfer (compare list of stockholders of Clarksburg (R. 62) with list of stockholders of Adamston (R. 67) and also see opinion of Circuit Court (App. 43). The Circuit Court held that the claims of creditors of Clarksburg may not be taken into account in deciding the issue, and since petitioner will not raise that point in this petition, figures indicating the percentage of indebtedness of Clarksburg prior to the reorganization held by creditors of Clarksburg who became stockholders of petitioner after the transfer will not be included in this statement. But, although

it is not necessarily pertinent to the issues herein raised, it is worthy of note that of the 1500 shares issued by petitioner, 1289 shares were acquired by persons formerly interested in the properties in one capacity or another. (R. 145).

QUESTIONS PRESENTED

The questions herein presented are:

(1) Where a corporation acquires property in connection with a reorganization, does the provision of Section 113(a)(7)(A) of the Internal Revenue Code that "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them" require that those persons who possess a 50 per centum interest or control in the properties after the transfer must also have had at least a 50 per centum interest or control in the properties prior to the transfer?

(2) Where there is a sufficient continuity of interest in a transaction to meet the requirements of a statutory reorganization, if a substantial part of those who held an interest or control in the properties transferred prior to the transfer possess a 50 per centum interest or control in the properties after the transfer, are not the provisions of Section 113(a)(7)(A) complied with so that the transferee is entitled to use as its unadjusted basis for depreciation of the properties so transferred the basis applied to the properties in the hands of the transferor?

(3) Did the Circuit Court err in affirming the decision of the Tax Court?

REASONS RELIED ON FOR THE ALLOWANCE OF A WRIT

(1) The decision of the Circuit Court of Appeals for the Fourth Circuit in this case is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Muskegon Motor Specialties Co.* v. *Commissioner of Internal Revenue*, 134 F. (2d) 904, (Cert. denied 320 U. S. 741, 88 L. Ed. 440).

(2) The Circuit Court of Appeals has decided in this case an important question of federal law which has not been, but should be settled by this Court, and the decision of the Circuit Court is wrong.

Wherefore, your petitioner respectfully prays that a writ of certiorari issue under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fourth Circuit, commanding that Court to certify and send to this Court a full and complete transcript of the record and all of the proceedings of the said Circuit Court had in the case numbered on its docket No. 5570 and entitled "Adamston Flat Glass Company, Petitioner v. Commissioner of Internal Revenue, Respondent," to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States; and that the judgment of the Circuit Court of Appeals for the Fourth Circuit may be reversed by this Court, and that your petitioner may have such other

and further relief in the premises as to this Court may seem proper.

CHARLES W. MOXLEY,
Counsel for Petitioner.

WILLIAM M. DRENNEN,
JACKSON, KELLY, MORRISON & MOXLEY,
Of Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

OPINIONS OF COURTS BELOW AND JURISDICTION

Reference has been made in the petition to the opinions of The Tax Court of the United States and The Circuit Court of Appeals for the Fourth Circuit filed in this cause and will not be repeated here.

Statements as to jurisdiction have also been made in the petition and are incorporated by reference herein.

STATEMENT OF THE CASE

A summary statement of the case has already been made in the preceding petition, which is hereby adopted and made a part of this brief.

In order to more clearly point up the issues involved in this case petitioner wishes to emphasize that it appears from the record and the opinion of the Circuit Court that petitioner acquired properties formerly belonging to Clarksburg Glass Company pursuant to a plan of reorganization and in connection with a reorganization as defined by the applicable statute effective in 1926, the year in which the transfer of assets occurred; that a little more than 50 per cent. of all the stock subscribed for and issued by the petitioner prior to and immediately after the transfer was subscribed for and issued to stockholders of Clarksburg Glass Company, the transferor; that the opportunity to acquire stock of peti-

tioner and go along with the reorganization was offered to all stockholders of Clarksburg and its principal unsecured creditor, Clarksburg Flat Glass Company, and in fact all were urged to go along (R. 51); that twelve stockholders of Clarksburg, most of whom were otherwise interested in the properties as stockholders of Clarksburg Flat Glass Company or direct creditors of Clarksburg, who held a little more than 47 per cent. of the voting stock and 44 per cent. of all the stock of Clarksburg Glass Company, acquired more than 50 per cent. of the stock issued by petitioner and thus effectively continued the management and control of the properties and their investments (R. 51, 95 *et seq.*)

SPECIFICATION OF ERRORS

(1) The Circuit Court erred in holding that the provision of Section 113(a)(7)(A) of the Internal Revenue Code that "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them" requires that those persons who possess a 50 per centum interest or control in the properties after the transfer must also have had at least a 50 per centum interest or control in the properties prior to the transfer.

(2) The Circuit Court erred in holding that where there is a sufficient continuity of interest in a transaction to meet the requirements of a statutory reorganization and a substantial part of those who held an interest or control in the properties

transferred prior to the transfer possess a 50 per centum interest or control in the properties after the transfer, the transferee is not entitled to use as its unadjusted basis for depreciation of the properties so transferred the basis applied to the properties in the hands of the transferor under the provisions of Section 113(a)(7)(A), Internal Revenue Code.

(3) The Circuit Court erred in affirming the decision of the Tax Court entered in this case.

ARGUMENT

Summary of Argument

POINT I—The decision of the Circuit Court is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Muskegon Motor Specialties Co.* v. *Commissioner of Internal Revenue*, 134 F.(2d) 904 (Cert. denied 320 U. S. 741, 88 L. Ed. 440).

POINT II—The Circuit Court decided in this case an important question of federal law which has not been, but should be, settled by this Court.

Point I

The decision of the Circuit Court is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Muskegon Motor Specialties Co.* v. *Commissioner of Internal Revenue.*

The opinion of the Circuit Court in this case and of the Sixth Circuit Court in the *Muskegon* case are

printed in the appendix to this brief for ready comparison.

The Circuit Court decided this case against petitioner on the ground that the words in Section 113 (a)(7)(A) of the Code, "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them" mean that those who hold a 50 per cent. interest or control in the new corporation after the transfer must also have had a 50 per cent. interest or control in the old corporation prior to the transfer; and that although former stockholders of Clarksburg held more than 50 per cent. of petitioner's stock after the transfer, they had held less than 50 per cent. of the Clarksburg stock, and therefore petitioner must use as its basis for depreciation the cost to it of the assets acquired from Clarksburg. This holding is directly in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in the case of *Muskegon Motor Specialties Co.* v. *Commissioner of Internal Revenue*, *supra*, holding that the requirements of a similar section in the Revenue Act of 1932 are met where *any* of the persons who were stockholders of the corporation owning the property prior to the transfer have an interest or control of 50 per centum or more in the property after the transfer.

The Circuit Court recognizes that its decision on this point is in conflict with the holding of the Sixth Circuit Court in the *Muskegon* case. In the opinion in this case it is stated (App. 48) "* * * In *Muskegon Motors Specialties Co.* v. *Commissioner*, 6 Cir.,

134 F. (2d) 904, however, such a statute was thought to be satisfied although a majority interest in one of two transferring corporations was seemingly not preserved in the transferee."

In the *Muskegon* case, two companies, M and G., were consolidated into taxpayer under a plan of reorganization. As a result of the reorganization 60% of the issued (40% of the authorized) common stock of the new corporation was acquired by persons who had held practically all of the stock of M. company prior to the reorganization. But the only stockholders of G. company who acquired stock in the new corporation were the president and his wife. They held 560 of the 2000 outstanding shares of said G. company prior to the reorganization, or 28% thereof, and acquired 25% of the issued (18-2/3% of the authorized) common stock of the new corporation.

In that case the Commissioner contended that the transaction constituted a reorganization within the definition in Section 112(i)(1)(A) of the Revenue Acts of 1928 and 1932 (which definition was the same in Section 203(h)(1)(A),[1] of the Revenue Act of 1926 applicable to the transaction here involved) and that by virtue of Section 113(a)(7) of the Revenue Act of 1932, which for practical purposes is identical with the provisions of Section 113(a)(7)

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[1]Section 203(h)(1)(A), Revenue Act of 1926.

"(h) as used in this section and sections 201 and 204—

"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of * * *, or substantially all of the properties of another corporation), * * ."

(A), Internal Revenue Code, the new company must use as the basis for depreciation of the assets transferred the basis in the hands of the two old companies. The Circuit Court agreed with the Commissioner, concluding that the transaction established a reorganization within the meaning of Section 112(i)(1)(A) and also that the transaction was within the provisions of Section 113(a)(7).

In its opinion in that case the Sixth Circuit Court discussed at length the phrase "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them." We quote from that opinion (App. 59): "* * * But the statute does not enact that 50 per centum control must remain in the 'same persons,' that is, in all of them; its terms are met if that quantum of control remains in 'any of them'. It matters not that all of the stockholders of the old corporations did not become common stockholders of petitioner. If 'any' who were stockholders in Gordon plus 'any' who were stockholders in Muskegon Michigan immediately after the transfer collectively control 50 per centum of petitioner, the statute is met."

The above interpretation of the identical phrase in Section 113(a)(7)(A) of the Code was the basis of petitioner's argument to the Fourth Circuit Court but was flatly rejected by that court, the opinion stating (App. 46): "We confine our attention to the interests of the Clarksburg stockholders, and must still determine whether the statute requires

that the stockholders who hold a 50 per cent. or greater interest or control after the transfer must have had at least a 50 per cent. interest or control before that event. In our opinion this question must be answered in the affirmative, for otherwise that continuity of interest which the statute was designed to meet would not prevail."

While the opinion of the Sixth Circuit Court was confined to the question whether the transferor stockholders had a 50 per centum *control* of the property after the transfer, the facts of the present case are equally strong on that point. There can be no question from the record that those stockholders of Clarksburg Glass Company who went along with the plan and acquired stock of Adamston, although they held slightly less than 50 per cent. of the stock of Clarksburg, *controlled* the properties in the hands of Clarksburg and during the receivership and retained that control even during the time title thereto was nominally in Pittsburgh Plate Glass Company and continued that control in Adamston. There can be no question that, in the present case as in the *Muskegon* case, control remained in the same persons (R. 85-99).

It is respectfully submitted that these two cases are in direct conflict. Under almost identical statutes and somewhat similar facts, at least so far as the G. company was concerned in the *Muskegon* case, both courts held that there was a reorganization but the fourth circuit in this case held that it was necessary, under the previously quoted phrase in Section

113(a)(7)(A), that those who possess a 50 per cent. interest or control in the properties after the transfer must also have held a 50 per cent. interest or control prior to the transfer, while the sixth circuit held that such was not necesary. So far as we are advised the *Muskegon* case is the most recent decision, prior to the decision in this case, directly interpreting the phrase contained in Section 113(a)(7)(A) of the Code as applied to facts similar to those in this case, and this Court has never interpreted the section, certiorari having been denied in the *Muskegon* case. The phrase has been under consideration by the Circuit Court of Appeals for the Seventh Circuit in the cases of *Monarch Electric & Wire Co.* v. *Commissioner*, 38 F. (2d) 417, *Fairbanks Court W. Groc. Co.* v. *C. I. R.*, 84 F. (2d) 18 (Cert. denied 299 U. S. 582, 81 L. Ed. 428); *Rex Mfg. Co.* v. *C. I. R.*, 102 F. (2d) 325, and *C. I. R.* v. *Bankers' Farm Mortgage Co.*, 145 F. (2d) 772. In none of those cases were the facts such as to require a determination of the precise question here involved with the possible exception of the *Rex Mfg. Co.* case, in which there was a dissenting opinion. The cases are discussed and quoted from in the opinion of the Circuit Court in this case (App. 48) and will be discussed under Point II of this argument. Suffice it to say that language used in the opinions in those cases only serves to further confuse the issue.

It is respectfully urged that the conflict and doubt arising from the two most recent Circuit Court cases should be resolved by this Court.

Point II

The Circuit Court decided in this case an important question of federal law which has not been, but should be, settled by this Court.

The Circuit Court of Appeals for the Fourth Circuit in this case decided that petitioner is not entitled to use as the basis for depreciation of certain of its assets for federal income tax purposes the basis of those assets in the hands of the former owner. This decision necessarily involved an interpretation of Section 113(a)(7)(A), Internal Revenue Code (26 U. S. C. A. §113).

As heretofore stated, we have been unable to find any cases wherein the pertinent part of Section 113(a)(7)(A) has been interpreted by this Court, nor has this Court interpreted the provision as it apeared in the Revenue Acts prior to codification of the internal revenue law. Certiorari was denied by this Court in the *Muskegon* case, *supra*, and in the *Fairbanks Court W. Groc. Co.* case, *supra*, and was apparently not sought in the other cases cited under Point I of this argument wherein the provision was involved.

The provision is in the present Internal Revenue Code, and from its nature, must remain in the Code, and it will be applicable to all reorganization transactions which occurred after December 31, 1917, and prior to January 1, 1936. It is applicable in determining not only the basis for depreciation of properties acquired in such transactions, but also in

fixing the basis for determining gain or loss on the present or future sales or other disposition of any properties so acquired.

This Court has often deemed the interpretation of the reorganization provisions in the Revenue Acts of 1924 through 1932 of sufficient importance to warrant its review. *Pinellas Ice & Cold Storage Co.* v. *C. I. R.*, 287 U. S. 462, 77 L. Ed. 428; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378, 80 L. Ed. 284, and its companion cases; *Letulle* v. *Scofield*, 308 U. S. 415, 84 L. Ed. 355; *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179, 86 L. Ed. 775, and its companion cases. In most instances those cases involved the determination of the proper basis for depreciation of property acquired in reorganizations occurring at about the same time the reorganization in this case took place and were governed by similar provisions of the pertinent Revenue Act. But it having been determined what constitutes a reorganization, so as to meet the first requirement of Section 113(a)(7)(A) of the Code, that the property was acquired "After December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization" the taxpayer and the Commissioner of Internal Revenue are still unadvised by this Court as to what is meant by the requirement that a 50 per cent. interest or control remain "in the same persons or any of them."

Under the rule as laid down by the Fourth Circuit Court in this case there may be a sufficient con-

tinuity of a substantial and proprietary interest to come within the definition of "reorganization," but the taxpayer may still be denied the right to use the basis of the transferror—or on the other hand under different circumstances, be given the right to use a "stepped up" basis, which the reorganization provisions were designed to prevent—simply because those persons holding a little more than 50 per cent. of the stock of the old corporation refuse to go along with the plan. Conversely, the Sixth Circuit Court, in the *Muskegon* case, has held that the words "or any of them" in the statute mean that if there is a sufficient continuity of interest to be within the purview of the reorganization provisions, if any of those who held a substantial stake, although less than 50 per cent., retain at least a 50 per cent. interest or control of the properties after the transfer, so that less than 50 per cent. new capital is brought in, the transferee must use as a basis for the properties transferred the basis of the former owner, adjusted as provided in Section 113(b) of the Code.

While the Code provision here under consideration is applicable only to transactions occurring prior to January 1, 1936, the provision is a basis provision and is therefore important in current and future income tax law. It is obvious from this case, which arises out of a transaction which occurred in 1926, and from the fact that some of the above cited cases with reference to interpretation of the reorganization provisions of the Revenue Acts of 1924, 1926, 1928 and 1932 have just recently reached the Courts, that any provision of the Internal Revenue Code

fixing the basis for depreciation and for determining gain or loss may be involved in litigation for a number of years to come.

The following cases are reviewed to point out that application of Section 113(a)(7)(A) presents both a difficult problem of administration for the Commissioner of Internal Revenue and difficult problems for taxpayers, which have not been solved by the inconclusive and at times conflicting opinions of the lower courts and which would be greatly aided by an interpretation of the section by this Court as applied to the case at bar wherein the question is squarely presented whether the 50 per cent. requirement of the law means that those who hold a 50 per cent. interest or control in the new corporation after the reorganization must also have held a 50 per cent. interest or control in the old corporation, and wherein, the petitioner believes, the conclusion of the Circuit Court was wrong.

The seventh circuit appears to have decided more cases involving an interpretation of this 50 per cent. clause than any other circuit. In *Monarch Electric & Wire Co.* v. *C. I. R.*, *supra*, prior to the transfer A. held 52 per cent interest and control, the remaining 48 percent. being in B, C and D. After the transfer B, C and D held all the common stock constituting a 52 per cent. interest and voting control and A. held all the voting preferred stock, constituting a 48 per cent. interest and voting control. All three circuit judges wrote opinions. The majority held that this met the requirements of a similar 50 per cent. statute. The third judge dissented on the

same theory used by the fourth circuit in this case, that the word "remain" means that the 50 per cent. interest or control in the new corporation must be held by the same persons who held at least a 50 per cent. interest or control before the transfer. Yet the Circuit Court in this case quotes from the majority opinions in that case in support of its conclusion. (App. 49).

In *Fairbanks Court W. Groc. Co.*, v. *C. I. R.*, *supra*, the seventh circuit considered the similar provision in the 1924 Act, except that 80 per cent. rather than 50 per cent. was required. There three companies, with no interlocking stock ownership, consolidated into taxpayer. All of taxpayer's stock was issued to all the stockholders in the three old companies in proportion to the value their interest in the aggregate properties transferred had to the total value of the properties transferred, and hence no single group held 80 per cent. of the new company. The Court held this to be compliance with the statute and stated, at page 20, "* * * We think it was the purpose of the section in question to prevent any so-called 'stepped-up' basis of valuation where no substantial amount of new capital was introduced." It will be noted that in the present case, under a 50 per cent. statute, less than 50 per cent. new capital was introduced. In the above two cases the Commissioner of Internal Revenue applied the basis of the former owners of the properties.

In *Rex Mfg. Co.* v. *C. I. R.*, *supra*, the seventh circuit again had the question before it. There former stockholders of the old company who held

more than 50 per cent. of the new company held only 48.2 per cent. of the old company stock unless the holdings of a deceased stockholder of the old company be considered. The Court held that the deceased stockholder's shares should be considered. The Commissioner in that case was on the other side of the fence and applied as a basis for the properties the cost thereof to the new corporation. Then again in *C. I. R.* v. *Bankers' Farm Mortgage Co.*, *supra*, where the new corporation had acquired 70 per cent. of the bonds of the insolvent old corporation a year prior to the sale of the assets for cash, and acquired the remaining 30 per cent. for stock just prior to the sale, the Commissioner insisted that cost basis to the new corporation should be used on the ground that after the purchase of a 70 per cent. interest for cash, only a 30 per cent. interest could have remained in control of the property and therefore the requisite 50 per cent. interest or control could not be carried into the new corporation. In holding for the taxpayer the Court recognized that the words "or any of them" modifies the requirement that 50 per cent. interest or control in such property remain "in the same persons." The example given by the court in its opinion, as quoted by the Fourth Circuit Court in its opinion in this case (App. 48), does not necessarily solve the question here presented but lends further uncertainty to the issue as applied to the facts in this case.

In the *Muskegon* case, *supra*, the Commissioner again applied the basis of the two old corporations even though stockholders of one of the old corpora-

tions who acquired stock in the new corporation held less than 50 per cent. of the stock in the old corporation, and the sixth circuit upheld his contention. And in this case the Commissioner takes the opposite stand under somewhat similar facts. The uncertainty in the interpretation of this section is further reflected in the opinion of The Tax Court of the United States in the recent case of *Montgomery Building Realty Co.* v. *Commissioner*, 7 T. C. 417, where Commissioner used the cost basis to the new corporation, in which the Court says: "It may be that the further requirement of a 50 per cent. interest or control 'in the same persons' is not identical with the concept of continuity of interest. See Mertens Law of Federal Income Taxation, Vol. 3, §21.97. But, if not, it is difficult to see that the statutory requirement does not represent an *a fortiori* case. It permits only a 50 per cent. interest without control and appears to require merely that some of the persons interested in the new corporation be the same, at least where they represent a majority of the equity owners of the predecessor."

It is therefore respectfully submitted that the Circuit Court has in this case decided an important question of federal law, that it reached the wrong conclusion on this question, and that the question has not been, but should be, decided by this Court for the guidance of the Commissioner of Internal Revenue as well as taxpayers.

CONCLUSION

This case presents an important question of federal law which this Court has not decided and upon which there is a direct conflict of opinion in two of the most recent cases in the Circuit Courts of Appeal in which the question has been presented. It is therefore respectfully submitted that this case, wherein it is believed the Circuit Court reached an erroneous conclusion, is one calling for the exercise by this Court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing the decision of the Circuit Court.

CHARLES W. MOXLEY,
Counsel for Petitioner.

WILLIAM M. DRENNEN,
JACKSON, KELLY, MORRISON & MOXLEY,
Of Counsel.

APPENDIX

STATUTES INVOLVED

Section 113, Internal Revenue Code (26 U. S. C. A. §113).

"Sec. 113. Adjusted basis for determining gain or loss—

(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—

* * *

(7) Transfers to corporation. — If the property was acquired—

(A) After December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

(B) * * *

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. * * *

(b) Adjusted basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be

the basis determined under subsection (a), adjusted as hereinafter provided. * * *"

Section 114, Internal Revenue Code (26 U. S. C. A. §114).

"Sec. 114. Basis for depreciation and depletion.

(a) Basis for depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property." * * *

OPINION OF UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT IN ADAMSTON FLAT GLASS CO. v. C. I. R.

SOPER, Circuit Judge:

Review is sought of an order of the Tax Court of the United States determining deficiencies in income taxes against the Adamston Flat Glass Company in the aggregate sum of $2552.80 for the calendar years 1940, 1941 and 1942. The asserted deficiencies were founded upon the taxpayer's use of the same basis for depreciation of certain assets acquired by it in 1926 as had been applied to the properties in the hands of the former owner. Taxpayer's contention is that the properties were acquired in connection with a statutory reorganization and that it is, therefore, entitled to use the basis for depreciation of the former owner, while the Commissioner contends that the taxpayer must use the cost of the properties to it as the basis. The legal issues involved require an interpretation of Section 203(h) (1) (A) of the Revenue Act of 1926, and Section 113(a) (7) (A) of the Internal Revenue Code and a determination of the questions (1) whether there was in fact a "reorganization" whereby there was an acquisition by the taxpayer of "substantially all of the properties of another corporation", and (2) whether "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them ***." Statutory provisions presently helpful are in the margin.*

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*Revenue Act of 1926, c. 27, 44 Stat. 12 (26 U.S.C.A., Internal Revenue

Adamston Flat Glass Company, the taxpayer, was incorporated June 18, 1926, to take over the properties of the Clarksburg Glass Company, hereinafter referred to as Clarksburg. The history of Clarksburg which led up to the circumstances now under consideration is shown in the following recital. Clarksburg was organized in 1913. Prior to the year 1924, while experimenting with a new process for manufacturing glass, it encountered financial difficulties and as a consequence, on August 27, 1924, through its president, W. M. B. Sine, it entered into an agreement with the Pittsburgh Plate Glass Company, hereinafter sometimes called Pittsburgh, whereby the latter company advanced to Clarksburg the sum of $70,000 to be used to pay current notes and accounts, and agreed to advance at its discretion additional sums from time to time not to exceed $100,000 in the aggregate. By this agreement, and in consideration of the financial and operating assist-

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Acts, pp. 150-1)

"Sec. 203.

"(h) As used in this section and sections 201 and 204—

"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation) ***."

26 U. S. C. A. §113 (Internal Revenue Code, 1945)

"Sec. 113. Adjusted basis for determining gain or loss—

(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—

***

(7) Transfers to corporation. If the property was acquired—

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them.

***

then the basis shall be the same as it would be in the hands of the trans-

ance rendered, Pittsburgh became actively interested in the operation of Clarksburg and received an option, never exercised, to purchase the Clarksburg properties if the then pending experiment proved successful. In September, 1924, pursuant to the agreement, Pittsburgh advanced the further sum of $100,000 secured by a second mortgage on the Clarksburg properties, which indebtedness, as of January 1, 1926, was evidenced by three notes all dated June 30, 1925, two in the amounts of $20,000 and $30,000 respectively, due on or before January 1, 1926, and one in the amount of $50,000 due on or before July 1, 1926. Of this indebtedness $70,000 was endorsed by Sine personally.

Early in 1925, for reasons of urgent financial expediency, the stockholders of Clarksburg and the stockholders of American Sheet Glass Company, another glass company operating in Clarksburg, undertook to effect a merger; and on February 9, 1925, the Clarksburg Flat Glass Company (hereinafter referred to as Flat Glass) was organized under the laws of West Virginia to take over the properties of

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feror, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. ***

***

(b) Adjusted basis. The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided. ***"

20 U. S. C. A. §114 (Internal Revenue Code, 1945)

"Sec. 114. Basis for depreciation and depletion.

(a) Basis for depreciation. The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property."

***

the two companies. Shortly thereafter, Flat Glass entered into agreements with Clarksburg and the American Sheet Glass Company whereby Flat Glass obtained an option, to be exercised within six months, to acquire the respective properties in exchange for shares of its stock and the assumption of all liabilities by Flat Glass. By July 7, 1925, Flat Glass had realized approximately $200,000 from the sale of its stock which was expended in payment of obligations of the Clarksburg and American Companies. It had received notes of Clarksburg totaling $171,800. The initial Pittsburgh loan of $70,000, made under the agreement of August 27, 1924, was repaid out of this money advanced by Flat Glass to Clarksburg. Continued financial difficulties prevented consummation of the projected merger; but efforts to bring it about were continued under the direction of W. M. B. Sine and H. B. Curtin and their associates, who were large stockholders in one or more of the three companies. Sine was the president and largest stockholder of Clarksburg, and was also a large stockholder of Flat Glass and American. He was also a direct unsecured creditor of Clarksburg for a small amount. Curtin was president and the largest stockholder of Flat Glass and the holder of a past due first mortgage note of Clarksburg in the amount of $18,-500.

On January 1, 1926, Clarksburg defaulted in payment of its notes due to Pittsburgh on or before that date, whereupon, by virtue of an acceleration clause, the note payable on or before July 1, 1926, also became due. On January 20, 1926, Pittsburgh insti-

tuted a suit in the District Court of the United States for the Northern District of West Virginia for the appointment of a receiver to foreclose its deed of trust. The foreclosure proceedings sought a sale of the properties subject to a first mortgage, executed by Clarksburg to W. M. B. Sine, Trustee, to secure notes in the sum of $150,000. A receiver, recommended by Sine, was appointed, and under his direction Sine operated the properties from January 22 to May 22, 1926. On April 16 judgment was entered in the equity suit in favor of Pittsburgh, providing that in default of payment within five days, the Clarksburg properties be disposed of by special commissioners at public sale in satisfaction of the Pittsburgh indebtedness and subject to the prior lien of the first mortgage. The sale took place on May 20, at which time Pittsburgh bid in the properties for the amount of its indebtedness.

Certain transactions in connection with the foreclosure of the second mortgage throw light on the taxpayer's position, which the Tax Court failed to sustain, that the purchase by Pittsburgh of the mortgaged property hereinbefore mentioned was merely a step in the plan of reorganization which the interested parties were endeavoring to put through. Prior to the suit, Pittsburgh expressed its willingness to accede to any plan that would permit Sine and his associates to retain the properties, provided Pittsburgh's debt was paid; but the attempt to raise the necessary funds failed and foreclosure followed.

In February, 1926, the annual meeting of Clarksburg was held and a committee was appointed to

arrange a general meeting of the stockholders of Clarksburg, Flat Glass and American to determine what should be done to protect their interests. In April, the committee recommended to a meeting of the stockholders of Clarksburg and Flat Glass that they form a new corporation and supply it with sufficient funds to enable it to buy the property at the sale. The name of Adamston Flat Glass Company was adopted, and Sine and J. A. McNicol were appointed trustees for the underwriters of the capital stock of the new corporation in order to obtain subscriptions to its stock. By May 17 sufficient funds had been subscribed, and on that date Pittsburgh wrote to its attorneys that it did not want the property but desired only to protect its interests and that Sine had perfected arrangements to enable him and his associates ultimately to acquire the property, and that if they should buy the property at the sale, Pittsburgh expected them to pay the notes with interest, and also the charges and costs of the sale and of the receivership; that one-third of the $100,000 with interest and the fixed charges would be paid in cash, and the remaining two-thirds of the $100,000 would be paid in two equal installments in one and two years following the sale. It was found by the Tax Court that this letter was the substance of the agreement between Pittsburgh, on one side, and Sine on the other. In this letter Pittsburgh asked its attorneys as to whether the end in view could be better effected by Pittsburgh or by Sine bidding in the property. According to the uncontradicted testimony of Sine, it was finally decided that Pittsburgh should buy the property and transfer it to the new

corporation and that the associates would make Pittsburgh whole so that it would lose nothing.

The day before the foreclosure sale to Pittsburgh, which took place on May 20, 1926, Sine deposited $33,500 with Pittsburgh's attorneys to show good faith. Pittsburgh bid in the property at the sale for $100,000 and the sale was confirmed on May 22, 1926. Pittsburgh received a deed of May 26, 1926, which recited that the consideration for the purchase was the sum of $100,000 of which amount $33,-500 was paid in cash on the day of sale, and the residue, evidenced by a note in the sum of $66,500 and bearing interest at 6 per cent. per annum, was to be paid on or before December 31, 1926. Immediately after the sale Sine took control of the plant and operated it for himself and his associates. Subsequently by letter of June 3, 1926, from Pittsburgh to Sine, and by his response under date of June 15, it was agreed that Pittsburgh would sell all the plant and property of Clarksburg to Sine for the amount of its claim against Clarksburg and in addition an amount sufficient to reimburse Pittsburgh for all payments, costs, expenses and out-of-pocket amounts arising from the foreclosure proceedings, to be paid as follows: $33,500, the amount of the cash payment made by Pittsburgh to the commissioners on the day of sale, with interest, plus the principal of $100,000 and interest on the notes due to Pittsburgh by Clarksburg, plus all of the costs of the suit, sale and receivership and counsel fees incurred therein, and any deficit in the receiver's account. It was stipulated that the offer must be

accepted and the sum of $80,000 paid within 30 days, and that within 30 days thereafter, an additional cash payment be made to reduce the total of the indebtedness to $66,666.66 for which Clarksburg was to give its notes, with interest at 6 per cent., secured by mortgage on the property. Acceptance of this agreement was made by Sine on behalf of the prospective new company. The new corporation was chartered on June 18, 1926, and became the taxpayer in this case. On June 29, 1926, a settlement was affected between it and Pittsburgh, under the terms of which Pittsburgh received the sum of $153,969.85, which consisted of the sum of $87,303.19 in cash and two notes of $33,333.33 each, payable in one and two years respectively. A deed conveying the property to the taxpayer was executed.

Upon these facts the Tax Court reached a conclusion which, if sound, was a sufficient basis for the dismissal of the taxpayer's petition. The court held that the taxpayer did not in fact acquire all the property of Clarksburg within the meaning of Section 203(h)(1)(A) because it bought the property from Pittsburgh which had become the independent owner thereof as purchaser at the foreclosure sale, and hence the continuity of a proprietary interest between Clarksburg, the original owner, and the taxpayer, required in a reorganization under the statute, was broken.* The reasons given for this

*See *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *le Tulle* v. *Schofield*, 308 U. S. 415; *Helvering* v. *Limestone Co.*, 315 U. S. 179; *Morgan Mfg. Co.* v. *Commissioner*, 4 Cir., 124 F. 2d 602; *C. M. Mead Coal Co.* v. *Commissioner*, 4 Cir., 72 F. 2d 22.

conclusion are stated in the court's opinion as follows:

> "* * * For we note, first that Pittsburgh had in mind also that if it had to buy the plant at receiver's sale, it would 'either operate the same or dispose of it, as circumstances seem to indicate'; second, that in its offer to sell on June 3, 1926, Pittsburgh set a deadline of 30 days after which its offer would be 'null and void'— not at all the act of a company obligated to be a mere transitory step in a merger, but indicative of its free and independent status as a vendor negotiating, on its own terms, a sale; and third, the record indicates that the petitioner settled with Pittsburgh for less than the amount of its claim and expenses —again showing Pittsburgh not in the position of one contracting, as a part of the original plan, to take its debt and pass the property along."

We do not think that this conclusion can be sustained, notwithstanding the finality which must be accorded to the Tax Court's findings of fact. It is based in part upon a misunderstanding of the court's own findings of fact and in part upon reasons which do not sustain it. The statement contained in the court's first reason, tnat Pittsburgh intended either to operate the plant or dispose of it, is taken from preliminary correspondence between Pittsburgh and its lawyers and was not part of the agreement between Pittsburgh and the Clarksburg interests which contemplated that Clarksburg was to acquire and operate the property. Nor is it a fact, as stated in the court's first reason, that the taxpayer settled

with Pittsburgh for less than the amount of its claim and expenses. The facts, found by the court, show that Pittsburgh suffered no loss. Moreover, it was immaterial that Pittsburgh set a time limit of 30 days within which the agreement for the transfer of the property should be effectuated. None of the circumstances indicate that there was a real break in the continuity of the transfer but, on the contrary, that the arrangement through which Pittsburgh was to acquire the property and then transfer it to Clarksburg was merely one step in an integrated transaction of the sort which has met with the approval of the Supreme Court. See *Helvering* v. *Limestone* Co., 315 U. S. 179; *Bondholders Committee* v. *Commissioner*, 315 U. S. 189. One has only to read the Tax Court's findings to realize that Pittsburgh and Clarksburg were working in complete harmony throughout to effectuate a plan whereby Pittsburgh would be made whole for its advances and a new corporation would recover the Clarksburg property free of all debts except the first mortgage.

Nevertheless, the Tax Court's decision must be sustained because the transfer to the taxpayer in connection with the reorganization did not meet the requirements of Section 113(a)(7)(A) of the Internal Revenue Code that "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them". The case was originally presented to us upon the assumption that stockholders who held a little less than one-half of the outstanding stock of Clarksburg before the transfer acquired or held a

little less than one-half of the stock of Adamston immediately after the transfer; and hence it was conceded that these holdings did not meet the conditions of the statute. The taxpayer seeks to make good the deficiency by the contention in the first place that when both shareholders and creditors of an insolvent corporation continue their investment by taking part in a statutory reorganization and acquiring a proprietary interest in a new corporation, both shareholders and creditors should be taken into account in determining whether a 50 per cent. interest has been preserved. In the second place the taxpayer contends that even if the stockholders of Clarksburg must be excluded from the count, there remained creditors of Clarksburg who had a sufficient stake in its properties and acquired more than a 50 per cent. interest in Adamston so as to meet the statutory requirements. Authority for the theory that creditors may have a sufficient interest or control in property transferred in connection with a reorganization to satisfy the terms of the statute is found in *Helvering* v. *Limestone Company*, 315 U. S. 179, in which it was held that the continuity of interest test in a statutory reorganization was satisfied when a creditors' committee was formed which instituted involuntary bankruptcy proceedings to enforce their demands and acquired stock of a new corporation to which the assets purchased by the creditors' committee at the bankruptcy sale were transferred. In effect the court said (p. 183) that for practical purposes the creditors became proprietors when they "took steps to enforce their demands against their insolvent debtor."

The taxpayer contends that the facts of the pending case indicate that the creditors of Clarksburg had an "equity" interest in its properties which survived the transitional stage. The total indebtedness of Clarksburg on January 22, 1926, when the foreclosure proceedings were instituted, was $592,405.13, and on May 22, 1926, when the sale to Pittsburgh was confirmed, the indebtedness was $655,703.43, including on both dates the first and second mortgage debts in the aggregate sum of $250,000. The mortgage creditors acquired no stock in Adamston with the exception of H. B. Curtin, the president and a large stockholder of Flat Glass, who held one of the first mortgage notes in the sum of $18,500. Curtin was also an unsecured creditor in the sum of $3,580.75. Sine, who was president and a large stockholder of Clarksburg, was an unsecured creditor in the sum of $532.26. These two men acquired 807 out of 1500 shares of Adamston outstanding. Unsecured creditors, including Sine and Curtin, who held aggregate claims in the sum of $4,384.39, acquired 814 shares of Adamston. Flat Glass, the largest unsecured creditor of Clarksburg, held notes which, with interest, amounted to the sum of $179,810.87. Flat Glass acquired no stock in Adamston but minority stockholders of Flat Glass acquired 1,067 shares of Adamston.

These computations show that creditors of Clarksburg owned more than a majority of stock of Adamston after the transfer; but that these creditors owned only a small part of the indebtedness of Clarksburg— less than half thereof even if the debt to Flat Glass

be included—before the reorganization took place. A like situation existed as to the stockholders. Figures which have been brought to our attention since the argument in this court show that Clarksburg had outstanding 18,215 shares of voting stock and 3,061 non-voting shares of which twelve shareholders owned 8,605 voting and 739 non-voting shares. These twelve stockholders acquired 754 of the 1,500 shares of Adamston. It thus appears that shareholders who owned approximately 44 per cent. of all the shares and approximately 47 per cent. of the voting shares of Clarksburg before the transfer owned a little over 50 per cent. of the shares of Adamston after the transfer.*

Since neither the creditors nor the shareholders separately considered held a 50 per cent. interest before the transfer, an essential requirement, as we shall show, the taxpayer is relegated to the contention that the two classes may be combined for the purposes of the statute. This contention is novel, so far as we are advised, and it is difficult to imagine a situation under which it would be tenable. It is not explained how the control of the properties could be shared by both stockholders and creditors, or how the relative weight to be given the two classes of interest could be ascertained in order to determine whether

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*These figures do not correspond precisely with the Tax Court's findings which showed that the stockholders of Clarksburg who remained acquired less than 50 per cent. of the stock of Adamston; but the figures are based upon lists of stockholders contained in exhibits stipulated by the parties. In view of the final conclusion we have reached, we accept the corrected figures without further reference of the case to the Tax Court.

the continuity of the required percentage had been maintained. The interests of stockholders and the interests of creditors are ordinarily in opposition to each other insofar as control of the corporate body is concerned. Shareholders of a corporation possess a proprietary interest in the corporate property, speaking in a broad rather than a technical sense, and control the corporate activities until the creditors assert their rights and take effective command, as in the case of a bankruptcy proceeding against an insolvent debtor; and when the debtor is insolvent in the bankruptcy sense, the rights of shareholders are eliminated and they may be entirely excluded from a corporate reorganization. See *Helvering* v. *Limestone Company*, *supra; Case* v. *Los Angeles Lumber Products Co.*, 309 U. S. 106.

We confine ourselves, however, to the situation in the pending case. The Tax Court made no finding as to insolvency of Clarksburg but assumed its existence; and we may fairly do the same, for although the book value of the assets exceeded the debts by a substantial amount when the receiver took charge and when the foreclosure sale took place, the physical assets sold for less than enough to pay the second mortgage debt and the expenses of foreclosure, and the accounts receivable were less than the accounts payable. Notwithstanding the unsatisfactory financial state of the corporation, only the second mortgage creditors asserted their right to control the properties before the transfer. These creditors were paid off; the holders of the first mortgage took no action but were content with the preservation of

their lien; and the unsecured creditors took no steps to take command of the disposition of the property.

All of the transactions which led up to the sale of the properties and the reorganization were conducted by the officers and stockholders of the corporations involved for the benefit of their shareholders. The loans by Pittsburgh to Clarksburg in 1924 were arranged by the President of Clarksburg. The ineffectual attempts at reorganization in 1925, when Flat Glass was formed, were made by shareholders of Clarksburg and American, and the formation of the taxpayer in 1926 was carried out as the result of the annual meeting of stockholders of Clarksburg in that year and subsequent joint meetings of the stockholders of Clarksburg, American and Flat Glass Companies. It cannot be said that the creditors of Clarksburg stepped into the shoes of the old stockholders in such a way as to give them the interest or control of the corporate property contemplated by the statute. It is doubtless true that the creditors, as well as the stockholders, of Clarksburg were associated in the activities which led up to the reorganization since to some extent the stockholders and the creditors were the same persons. And since both creditors and stockholders became stockholders in the new enterprise, it may be said in a broad sense that some continuity of interest by both classes survived the transfer. But we are dealing with a statute which confers a privilege upon taxpayers under certain conditions, and unless these are complied with, the basis for the computation of gains and of depreciation must be the same as that imposed upon tax-

payers generally. Hence we hold that the claims of the creditors may not be taken into account in deciding the present issue.

We confine our attention to the interests of the Clarksburg stockholders, and must still determine whether the statute requires that the stockholders who hold a 50 per cent. or greater interest or control after the transfer must have had at least a 50 per cent. interest or control before that event. In our opinion this question must be answered in the affirmative, for otherwise that continuity of interest which the statute was designated to meet would not prevail. The provision of the statute, that in case of a corporate reorganization the gain upon a sale and the depreciation from wear and tear of the property shall be estimated upon the same basis as if the property were in the hands of the transferor, was intended to take into account the actual situation and to postpone the recognition of gain or loss until it had in fact been realized. Reorganizations " *** are deemed by Congress to be transitional, continuing transactions which are not sufficiently 'closed' to justify *economically* (though there may be a different answer on a strict *legal* basis) the imposition of capital gains tax at the immediate moment of an 'ordinary business' transaction." Paul, Studies in Federal Taxation (3d Ser. 1940) 4-5. This thought is revealed in the phrase "an interest or control of 50 per cent. or more *remained* in the same persons."

If this underlying purpose of the statute is kept in mind, it will be seen that the continuance of the 50

per cent. interest in both the original owner and in the transferee is essential and that the words "or any of them" in the concluding portion of the section were used to give elasticity to the provision and make it unnecessary for persons holding or controlling a majority interest in the original owner to control precisely the same proportionate interests in the transferee. This is the view taken in a General Counsels' opinion in reference to the 80 per cent. requirement in the Revenue Act of 1926. G. C. M. 7472, IX-1, Cum. Bull, 184, 191-2 (1930). See also Mertens, Law of Federal Income Taxation (1942) §§21.97, 21.98.

The opposing argument is grounded largely on the concluding words of the requirement that a 50 per cent. interest or control in the property shall remain in the same persons or *any of them*; and it is contended that this requisite is satisfied if a majority interest is held by *any* of the stockholders of the transferor after the transfer. This contention, if given full force, would lead to the unreasonable conclusion that the ownership of a 50 per cent. interest after the transfer by one who held as little as 1 per cent. of the stock before the transfer would be sufficient. The taxpayer in the pending case, it is true, would not urge so extreme a position, but would be content with a ruling that the stockholders of the transferee should have previously held a substantial interest in the transferor. It has been held under a variety of circumstances that the rentention of a substantial rather than a controlling interest in the transferee corporation satisfies the requirement of a statutory

reorganization. *Miller* v. *Commissioner*, 6 Cir., 84 F. 2d 415; *Nelson* v. *Helvering*, 296 U. S. 374; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *Helvering* v. *Watts*, 296 U. S. 387.*

But in these cases there was involved no statutory requirement for the retention of an interest of any specified amount in the transferee, such as that now under consideration. In *Muskegon Motor Specialties Co.* v. *Commissioner*, 6 Cir., 134 F. 2d 904, however, such a statute was thought to be satisfied although a majority interest in one of two transferring corporations was seemingly not preserved in the transferee. In *C. I. R.* v. *Bankers Farm Mortgage Co.*, 7 Cir., 145 F. 2d 772, upon which the taxpayer also relies, the court used the following language in construing the phrase "or any of them" in the section now under examination. (p. 774)

> " *** We construe the modifying phrase to mean that if A and B held 90% at the beginning of the reorganization and A held 60% after the reorganization was effected, there would be a statutory continuity of interest. No other good reason for the existence of the modifying phrase 'or any of them' has been suggested or occurs to us. It cannot be ignored in applying this statutory test to the facts in the instant case."

It does not appear, however, that the court intended to rule that the parties who retain a 50 per

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*It is pointed out in Paul, Studies in Federal Taxation (3d Ser. 1940) 103-4 that in the *Watts* case the transferor retained 45.34 per cent. interest, in the *Nelson* case 38.46 per cent., and in the *Minnesota Tea* case 55.85 per cent.

cent. interest need not have had so large an interest before the transfer, because in that case the creditors, through whose efforts the reorganization was accomplished, seem to have had more than a 50 per cent. interest at both points of time. Moreover, the court did not overrule or even mention earlier decisions in which under similar statutory provisions the need for the existence of the specified interest both before and after the reorganization process is plainly indicated. Thus in *Monarch Electric and Wire Co.* v. *Commissioner*, 7 Cir., 38 F. 2d 417, 418-9, it was said:

> "* * * In our judgment the working of the statute is not ambiguous in this particular. It explicitly says that 'if an interest or control of 50 per centum or *more* remains in the same persons, or *any of them*,' (italics ours) then the statute applies. Before the reincorporation Deutsch, it is true, owned and controlled more than 50 per cent. of the stock; but it is also true that he, with either one or more of the Schwabs, at that time owned and controlled more than 50 per cent. of the stock. After the reincorporation we find the persons holding the stock in the new corporation are identical with the stockholders in the old, and that Deutsch, with either one or more of the Schwabs, still owns and controls more than 50 per cent. of the stock of the new corporation; and this brings the transactions squarely within the statute."
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> * * *
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> "* * * To my mind the evident intent of the section is, that if, after any such change, any person or persons, singly or collectively, shall

> hold in the reorganized business as much as 50 per cent. of the entire interest or control therein, and are the same person or persons who, singly or collectively, held as much as 50 per cent. interest or control in the old business, the reorganized business shall not, for the purpose of determining invested capital, be allowed a greater value on any of its assets than would have been allowed, upon the same assets, to the old business had there been no reorganization.
>
> "Here not only 50 per cent., but the entire ownership—and so the entire control or interest in the consolidated business—is in the same persons, and in none others, as was the entire interest and control in the old business."

The holding of this case was expressly reaffirmed by the Seventh Circuit in *Fairbank Court W. Groc. Co.* v. *C. I. R.*, 84 F. 2d 18. To the same effect is the decision in *Rex Mfg. Co.* v. *Commissioner*, 7 Cir., 102 F. 2d 325; see also *Republic Steel Corp.* v. *United States*, Ct. Cl., 40 F. Supp. 1017.

The decision of the Tax Court is therefore

Affirmed.

OPINION OF UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT IN MUSKEGON MOTOR SPECIALTIES CO. v. C. I. R.

HICKS, Circuit Judge.

The petitioner, Muskegon Motor Specialties Company, seeks a review of a decision of the Board of Tax Appeals redetermining deficiencies in its income and excess profits taxes for 1934 in the respective amounts of $5,596.51 and $2,035.10.

Decision turns upon determination of the basis for computing depreciation of petitioner's assets. If the basis was cost at the time of their acquisition, petitioner should prevail; but if the net unrecovered cost to the two companies from which the assets were acquired, the Board's decision must stand.

In 1928 there existed in Michigan the L. O. Gordon Manufacturing Company, engaged in the manufacture of cam shafts and herein called Gordon, with outstanding capital stock of 2,000 shares having a par value of $100, and the Muskegon Motor Specialties Company, engaged in a similar business, herein called Muskegon Michigan, with outstanding capital stock of 4,500 9/10 shares of no par value. Of Gordon's 2,000 shares, L. O. Gordon, its president, and his wife owned 560 shares; and of Muskegon Michigan's 4,500 9/10 shares, 2,228 were owned by Flanders Investment Company, a personal holding company of Fred L. Flanders, Muskegon Michigan's president.

On November 7, 1928, a circular letter was sent to the stockholders of Muskegon Michigan, setting

out a plan for consolidating Gordon and Muskegon Michigan and stating that it had been unanimously agreed upon by the officers and directors of both companies, by all the stockholders of Gordon, and by 96% of the stockholders of Muskegon Michigan. All of Muskegon Michigan stockholders must ultimately have agreed, since all participated in the merger.

On November 24, 1928, petitioner, a Delaware corporation, was organized "for the purpose of effecting a consolidation of the businesses" of Gordon and Muskegon Michigan with an authorized capital of 62,500 no par Class A shares, carrying a $2.00 dividend, and 187,500 of no par common. L. O. Gordon was elected petitioner's president and Flanders its treasurer and chairman of the board.

Cash was acquired from the sale to three banks of all the Class A shares and 15,000 of the common stock for $1,385,000; and from the declaration later by Gordon of a $60,000 dividend which had already been assigned to petitioner.

On November 27, 1928, petitioner organized two subsidiary corporations, the Midland Investors, Inc., herein called Midland, and Norton Securities Company, herein called Norton, with stock issues of 5,000 and 3,750 no par shares, respectively. Petitioner purchased the entire issue of Midland for $45 per share, and of Norton for $100 per share.

Using the balance of its cash, some of its own common stock and the entire issues of Midland and Nor-

ton, petitioner acquired the entire outstanding stock of Gordon and Muskegon Michigan. To aid petitioner in this purchase, L. O. Gordon had previously obtained options upon the 1,440 shares of Gordon stock which he and his wife did not own; and the Flanders Investment Company, and other stockholders of Muskegon Michigan, deposited their shares with the Union National Bank of Muskegon Michigan for exchange for cash and stock of petitioner.

On December 6, 1928, these acquisitions were consumated as follows:

Petitioner acquired all of the shares of stock of Gordon in the following detailed manner,—from Gordon and wife 560 shares for which petitioner paid $15,492.40 in cash; 5,000 shares of Midland and 35,000 of its own common; from the other stockholders the 1,440 remaining shares of Gordon for $433,507.60 in cash, Gordon's options thereon having been assigned to petitioner.

On the same date petitioner acquired from Flanders Investment Company 2,228 shares of Muskegon Michigan for $6,652.23 in cash, the 3,750 shares of Norton, and 37,118 1/3 shares of its own common; and from the remaining stockholders of Muskegon Michigan the 2,272 9/10 remaining shares for $389,346.77 in cash, and 37,881 2/3 shares of its own common.

In making these acquisitions petitioner had issued all of its Class A stock and 125,000 of the 187,500

authorized shares of its no par common, the remaining 62,500 shares of its no par common being reserved for conversion of the Class A shares. Before these acquisitions on December 6, 1928, no former Gordon shareholder had owned any Muskegon Michigan stock, and no former Muskegon Michigan shareholder had owned any Gordon stock. Thereafter no former Gordon or Muskegon Michigan shareholder owned any of petitioner's Class A or any of the 15,000 shares of no par common stock which it had sold to the banks; but the combined holdings of petitioner's common stock by former Gordon and Muskegon Michigan shareholders totaled 110,000 shares.

On January 23, 1929, special meetings of the stockholders and directors of Gordon and Muskegon Michigan were held, which authorized a conveyance of all the properties and assets of each corporation to petitioner upon the assumption by the latter of all the debts and liabilities of each and directing thereafter the dissolution and surrender of the charter of each.

Petitioner claims that in determining depreciation it is entitled to the basis of cost to it of the depreciable properties acquired from Gordon and Muskegon Michigan. This cost, for the depreciable assets acquired from Gordon, was $364,684.10, and for those acquired from Muskegon Michigan, $490,896.88. The Board held that petitioner must use the basis of its predecessors, that is, the unrecovered cost to them, on the date of the transfer, of

their assets to petitioner. The unrecovered cost of the Gordon assets on that date was $214,675.51 and of the Muskegon Michigan assets was $23,369.63.

Sec. 114(a) of the Revenue Act of 1934, 26 U. S. C. A. Int. Rev. Acts, page 701, provides that the basis for depreciation in respect of any property shall be the adjusted basis provided in Sec. 113(b) thereof, 26 U. S. C. A. Int. Rev. Acts, page 700. This section is made to depend upon Sec. 113(a) which provides "the basis of property shall be the cost of such property" with certain exceptions, number "(12)" of which is relied upon by the Commissioner. This Sec. 113(a) (12) is as follows: "(12) Basis established by Revenue Act of 1932. If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932 was prescribed by section 113(a) (6), (7), or (9) of such Act, then for the purposes of this Act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932." This subsection (12) must control in determining the amount of petitioner's deficiencies in income and excess profits taxes for 1934.

The Commissioner's contention is that Sec. 113(a) (7) controls the situation. Pertinent portions thereof follow: "(7) Transfers to corporation where control of property remains in same persons. *If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or*

control in such property of 50 percentum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. * * *" (Italics ours.)

A "reorganization" is defined in Sec. 112(i) (1) (A) of both the 1928 and 1932 Revenue Acts, 26 U. S. C. A. Int. Rev. Acts, pages 379, 513, as among other things, "a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)."

Petitioner concedes that the transactions hereinbefore described fall within the literal language of this definition of a reorganization, since petitioner had acquired all of the stock of Gordon and Muskegon Michigan; but insists that under decisions of the Supereme Court and of this and other courts, there must be found in addition a continuity of interest betwen the old and new corporations, and that the interest of the transferors or their stockholders must represent a substantial part of the value of the thing transferred. Petitioner, among other cases, cites Helvering v. Minnesota Tea Co., 296 U. S. 378, 56 S. Ct. 269, 80 L. Ed. 284; Miller v. Comm'r., 6 Cir., 84 F. 2d 415; Banner Mach. Co. v. Routzahn,

6 Cir., 107 F. 2d 147; Mascot Stove Co. v. Comm'r., 6 Cir., 120 F. 2d 153, and Templeton's Jeweler's Inc., v. United States, 6 Cir., 126 F. 2d 251.

Petitioner further concedes that there was "some continuity of interest" between Muskegon Michigan stockholders and itself since each of the Muskegon Michigan stockholders received stock in petitioner but denies that the continuing interest represented a substantial part of the value of the thing transferred. We are not in accord.

In Miller v. Comm'r., supra, we pointed out that each case must in its final analysis rest upon its own peculiar facts. We said substantially the same thing in Banner v. Comm'r., supra. In the Miller case we ruled that a controlling interest in the transferee corporation was not necessary to reorganization. In Le Tulle v. Schofield, 308 U. S. 415, 60 S. Ct. 313, 84 L. Ed. 355, the court in reviewing several previous decisions as to what constituted a substantial stake of the transferor in the new enterprise, pointed out that such a stake was thought to be retained where a large proportion of the consideration was in common stock of the transferee, citing the Minnesota Tea case, supra.

Here, in addition to cash and other stock, the Muskegon Michigan stockholders received 60% of the issued (40% of the authorized) common stock of a corporation whose transferors had had consolidated earnings averaging over $240,000 for each of the three years before their union in petitioner. Moreover, dividend commitments of the new corpo-

ration, which take precedence over common stock, were only $125,000 per year. We think that these potential earnings, plus a large share in the control of petitioner as represented by the common stockholdings, represented substantial value.

Gordon is nearer the border line. Of the 2,000 shares of Gordon which were transferred by stockholders to petitioner, 1,440 were paid for in cash. Gordon and wife, representing 560 shares of Gordon, became stockholders in petitioner. However, their common stockholdings therein, over and above payments to them in cash and other stock, were 35,000 shares. This represented more than 25% of petitioner's issued common stock and 18 2-3% of the authorized stock. Its potential earnings and the voice it gave its owners in management, coupled with L. O. Gordon's presidency of petitioner, constitute a "substantial stake" therein.

We conclude that these transactions establish a "reorganization" within the meaning of Sec. 112(i) (1) (A).

We come now to the question, whether under Sec. 113(a) (7), "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them." As we have noted, there was no interlocking ownership betwen Gordon and Muskegon Michigan prior to the transfer. And petitioner, taking each transferor company separately, points out that after the transfer Gordon stockholders owned but 18 67/100% of the authorized common stock of peti-

tioner, and the Muskegon Michigan stockholders but 40%.

We confine our attention to the question whether the transferor stockholders had a 50 per centum *control* of the property of the petitioner immediately after the transfer. In the first place we seriously doubt, as petitioner urges, that the two sets of stockholders of the transferring corporations, must be separately considered in answering the question whether this 50 per centum of control existed. The statute enacts that the "control" must have "*remained* in the same persons or any of them." (Italics ours.) The use of the word "remained" connotes a continuity of control both before and after the transfer. And if such control continued, it obviously must have continued or "remained" in those persons who had had it before, namely, Gordon and Muskegon Michigan stockholders. In other words, control "remained" in the stockholders of the transferee corporation if they had been owners of common stock in one of the transferor corporations, irrespective of the fact that they may or may not have been stockholders in both. If transferor stockholders, which includes those of Gordon and Muskegon Michigan, collectively owned 50 per centum of the common stock of the new corporation, we think the statute is satisfied. Fairbanks Court W. Groc. Co. v. Comm'r., 7 Cir., 84 F. 2d 18. But the statute does not enact that 50 per centum control must remain in the "same persons," that is, in all of them; its terms are met if that quantum of control remains in "any of them." It matters not that all of the

stockholders of the old corporations did not become common stockholders of petitioner. If "any" who were stockholders in Gordon plus "any" who were stockholders in Muskegon Michigan immediately after the transfer collectively control 50 per centum of petitioner, the statute is met. This is clearly so on the facts since former stockholders of Gordon own 18 2/3% of petitioner's common stock, and former stockholders of Muskegon Michigan own 40% of petitioner's stock, aggregating more than 50 per centum thereof.

But petitioner urges that even if the statute be satisfied as to common stock ownership that is not sufficient. The argument is that any stockholder, common or otherwise, because of his power to veto various arrangements in a sense has "control" over the property of the corporation; and that therefore the "control" called for in the statute must be a 50 per centum control of all stock, Class A as well as common. Petitioner cites Sec. 112(j) of the Revenue Act of 1932, 26 U.S.C.A. Int. Rev. Acts, page 514, in support of its position, wherein it is enacted, "the term 'control' means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation." The answer to this proposition is that Sec.112(j) expressly limits its coverage to Sec. 112. See Bickford's Inc., v. Helvering, 2 Cir., 98 F. 2d 568, wherein the same contention was raised and rejected.

Finally, the taxpayer urges that the real transferors were the stockholders and not the corpora-

tions; and that therefore the transferors' cost basis should be increased by the amount of gain recognized to them. The answer to this is implicit in all that we have just said. It is sufficient to say in amplification that the facts do not support such a view of this transaction. It is quite evident that no event has occurred which placed the stockholders, as against the transferor corporations, in control of these assets. So far as the record reveals, no stockholders' committees were active. The transaction seems to us to be what it purports to be, namely, a reorganization through intercorporate action. Compare Bondholders Committee v. Comm'r., 315 U. S. 189, 62 S. Ct. 537, 86 L. Ed. 784.

The decision of the Board of Tax Appeals is affirmed.